

No. 12,664

IN THE

United States Court of Appeals
For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GRACE H. KELHAM, LEILA H. NEILL, ELLIS
M. MOORE, HARRIET H. BELCHER and
LILLIE S. WEGEFORTH,
Respondents.

BRIEF OF AMICUS CURIAE IN SUPPORT OF
RESPONDENTS' PETITION FOR A REHEARING.

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Rosekrans Investment Company,
John N. Rosekrans and Alma
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in No. 12,663,*

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Table of Authorities Cited

Cases	Pages
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Willeuts v. Marion Dairy Company (1927), 275 U.S. 215...	4, 5

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**BRIEF OF AMICUS CURIAE IN SUPPORT OF
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Pursuant to stipulation and order filed herein on October 26, 1950, counsel for respondents in proceedings Nos. 12,657 and 12,663, file this Brief as Amicus Curiae in support of Respondents' Petition for Rehearing in the above entitled proceeding.*

The Court has reversed the decision of the Tax Court in a brief opinion, which counsel considers completely fails to meet the problem raised by the situation present in these cases. The Court, in effect, holds

*The filing of this brief is not prompted by any disharmony among counsel for the various taxpayers concerned with the disposition of the case, but by a feeling that professional duty calls for a separate presentation of counsel's reaction to the decision reached in the proceeding.

that any distribution of the earnings or profits of a corporation earned after February 28, 1913, is gross income to the recipient.

It may well seem, on first impression, that the question is simple and that respondents and thirteen of the sixteen members of the Tax Court have missed the simple solution and unnecessarily involved the question. Counsel believes, however, that the solution is not so apparent as the Court assumes and that the cases warrant further consideration by this Court.

The question whether a distribution of current earnings constitutes gross income was expressly and intentionally withdrawn from the cases by the stipulation of facts in the Tax Court and all such distributions, pursuant to that stipulation, were found taxable by the judgment of that Court. (Transcript pages 42 and 43.) As a result, the sole question to be considered and answered in this proceeding is whether undistributed earnings of one year can be regarded as having been *accumulated* in the face of a deficit in paid-in capital, so that a distribution in a subsequent year in excess of the current earnings of such subsequent year constitutes gross income in the hands of a recipient thereof.

The Court apparently feels that it has justified its conclusion that such non-current earnings are "accumulated" earnings, notwithstanding the existence of a deficit in paid-in capital, when it states on page 3 of the opinion:

"Congress drew a line between February 28, 1913, and March 1, 1913."

This statement ignores the conclusion of the Supreme Court in *Helvering v. Canfield* (1933), 291 U.S. 163, that no such impenetrable line was drawn by Congress. The Supreme Court says (291 U.S. 167):

“The fundamental contention of the taxpayers is that the statute created two distinct periods for tax purposes; that the accumulations for each period constituted ‘a fixed and static amount, not to be changed by happenings after the end of the period.’ That the statute does relate to two periods, the dividing line being March 1, 1913, and that the periods are distinct, is obvious. But it does not follow because there are two distinct periods that the accumulations for each period constitute ‘a fixed and static amount’ and are to remain unaffected despite the vicissitudes of business.”

The Supreme Court had just previously stated in its opinion:

“* * * *We are not here concerned with capital in the sense of fixed or paid-in capital, which is not to be impaired, or with the restoration of such capital where there has been impairment. No case of impairment of capital is presented.*” (Italics supplied.)

It therefore is necessary for this Court to consider the fact that there had been an impairment of the paid-in capital of the Spreckels Company at the time the distributions to stockholders were made and, likewise, to consider the effect of such impairment on the earnings and profits of the Company.

It is obvious the Supreme Court did not intend by its decision in the *Canfield* case to foreclose a consideration of the effect on corporate earnings of the right of a corporation to restore an impairment of its paid-in capital, since the Court had only a few years previously, in *Willcuts v. Marion Dairy Company* (1927), 275 U.S. 215, a case involving the determination of invested capital for excess profits tax purposes, held (275 U.S. 218):

“* * * But it is a prerequisite to the existence of ‘undivided profits’ as well as a ‘surplus,’ that the net assets of the corporation exceed the capital stock. Hence, where the capital is impaired, profits, *though earned and remaining in the business*, if insufficient to offset this impairment do not constitute ‘undivided profits.’” (Italics supplied.)

It follows that this Court in adopting the reasoning of the dissenting opinion in the Tax Court, has undertaken to read into the Revenue Acts an intention on the part of Congress to subject to taxation, as a distribution of corporate income, a classification of receipts of the corporation which the Supreme Court refuses to recognize as surplus or profits.

By this interpretation of the Revenue Act, the Court has raised, but failed to consider or answer the question as to whether, as contended in Respondents’ Brief, page 29:

“* * * section 115(a) of the Internal Revenue Code is unconstitutional if it is construed to im-

pose an income tax upon distributions which are in excess of current earnings and where the corporation has no accumulated earnings or profits.”

A distribution of capital is not taxable under the Sixteenth Amendment and hence the result of the present decision will be to confirm an attempted levy on capital without apportionment among the several states as required by Section 2 of Article I of the Constitution of the United States.

The Respondents in proceedings Nos. 12,657 and 12,663, represented by counsel appearing *amicus curiae*, who have stipulated that their proceedings abide the event of the decision in this proceeding, request that Respondents’ Petition for a Rehearing be granted in order that this Court may consider further the application of the *Canfield* and *Willcuts* cases and the constitutional question now fully presented by the reversal of the Tax Court.

Dated, San Francisco, California,
December 3, 1951.

Respectfully submitted,

WALTER SLACK,

Amicus Curiae, Counsel for Alma de Bretteville Spreckels, Respondent in No. 12,657, and for Spreckels-Rosekrans Investment Company, John N. Rosekrans and Alma Spreckels Rosekrans, Respondents in No. 12,663,

CERTIFICATE.

The undersigned hereby certifies that in his judgment respondents' petition for a rehearing is well founded and that it is not interposed for delay.

Dated, San Francisco, California,
December 3, 1951.

WALTER SLACK,
Amicus Curiae.

